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TRANSFER PRICING AS A MECHANISM OF TAX PLANNING AND ECONOMIC RISK MANAGEMENT

Transfer pricing (hereinafter referred to as TP) is a complex and important aspect of international business that affects the profitability of enterprises, tax liabilities and overall management strategy. Transfer pricing occurs when companies owned or controlled by the same owner engage in trading transactions with each other.

The main goal of TP is to establish prices that are consistent with those that would have occurred between independent parties in arm's length transactions. In this case, when goods or services are sold between related companies, prices should be market-based and reflect the real value on the market. Establishing such market prices helps to avoid tax risks.

TP as a tax institution emerged in Ukraine against the backdrop of increased attention to multinational corporations and international trade. The basis for the national legislation was the Guidelines of the Organization for Economic Cooperation and Development (OECD), the main provisions of which are implemented in Article 39 of the Tax Code of Ukraine (hereinafter - the TCU) [3].

Unlike many other requirements of the tax legislation, TP does not have a clear regulatory framework. The recent amendments to Article 39 of the Tax Code of Ukraine aim to increase transparency and fairness in the field of transfer pricing [2]. They are intended not only to ensure that prices in controlled transactions align with market conditions but also to reduce opportunities for tax manipulation.

TP documentation is a certain package of materials obtained as a result of the analysis of international taxation. Such documents characterize the company's activities related to controlled transactions, the terms of controlled transactions, the circumstances under which the terms (agreements) were reached (market conditions), etc.

TP documentation includes:

- Report on controlled transactions (annexes to the Report).
- Primary documentation related to controlled transactions (e.g., contracts, declarations or certificates).
- Company's financial statements and auditor's report.
- Analytical research files.

According to Ukrainian law, TP documentation must be submitted to the controlling authorities upon request of these authorities within a period of time established from the date of receipt of such request. According to Article 39 and Clause 140.5.4 of the TCU, the main rule that regulates and determines the need to submit TP documentation is required if the transactions are considered to be controlled [3].

The criteria that determine that a certain transaction is controlled include:

1. The monetary amount of the transaction with the counterparty. The transaction amount must be at least UAH 10 million. It does not matter how the contract is concluded: directly or through an intermediary.

2. The taxpayer's income must be at least UAH 150 million. If the company receives less income, it cannot conduct controlled transactions.

3. Counterparty in a controlled transaction. In order for a transaction to be controlled, the counterparty must meet at least one of the following parameters:

- the counterparty is a related party;
- the counterparty is a commission agent;
- the counterparty is located in the territory of a state with a low-income tax rate;
- the counterparty has an organizational and legal form that exempts it from income tax;
- the Ukrainian company is a permanent establishment of a non-resident with whom business transactions were carried out.

In this case, there is no need to comply with all three factors; only one is enough.

However, if the transaction is not controlled, this is not a reason to avoid submitting TP documentation. Thus, in accordance with clause 140.5.4 of the TCU, a taxpayer must prepare documents if its transactions, although not controlled, were concluded with the following counterparties:

- located in a country with a low-income tax rate (the list of such countries is approved by the Cabinet of Ministers of Ukraine);
- the legal form of the counterparty does not require it to pay income tax in the country where it is considered a resident.

If a taxpayer participates in a controlled transaction, its taxable income is determined on an arm's length basis.

The taxable income received by a taxpayer participating in one or more controlled transactions is deemed to be subject to the arm's length principle if the terms of a particular transaction do not differ from the terms and conditions applied between unrelated parties in comparable uncontrolled transactions.

Another key TP concept is the business purpose. The absence of a business purpose in transactions between related parties may indicate that these transactions are conducted solely to minimize tax liabilities.

However, the current legislation of Ukraine, particularly the TCU [3], does not always provide comprehensive answers to this concept, creating certain gaps and raising many questions. Business purpose (or economic feasibility) justifies the economic substance of transactions between related parties.

The basic idea is that any transaction should have a logical business reason other than tax benefits. The lack of a clear definition and criteria for assessing the business purpose creates risks for business and complicates the work of tax authorities [1, p. 72].

One of the main problems is the lack of a clear definition of the business purpose and objective criteria for its assessment in the legislation. The absence of

such a definition complicates the decision-making process for determining the legitimacy of transactions and can lead to misinterpretations by tax authorities. The business environment needs more clarity and transparency regarding the business purpose requirement to ensure that tax rules are applied correctly and to avoid misunderstandings and conflicts.

Therefore, businesses should have a clear TP strategy, including internal procedures and controls, to avoid negative consequences. In our opinion, the elements of such a strategy may include:

- identification of controlled transactions and ensuring compliance with TP legislation;
- identification of risks (sensitivity analysis of changes);
- identification of the company's related parties;
- analysis of the TP policy and intra-group contracts;
- functional analysis and value chain analysis;
- determination of profit and cost allocation;
- preliminary approval of pricing during the preparation of transactions;
- review and comparative analysis of current operations in the field of foreign economic activity;
- concluding contracts with an analysis of tax risks.

Thus, using a certain TP strategy allows companies to ensure the stability and efficiency of their financial activities in a changing market environment. However, the application of TP requirements is a rather subjective factor. There are certain difficulties in arguing the controlled transactions to the taxpayer, which are expressed through the comparability criteria of uncontrolled transactions with controlled ones fixed at the legislative level. Incorrect pricing can lead to conflicts with tax authorities, large fines and double taxation. Taxpayers must comply with all TP legislation and be prepared for changes in this area.

Information sources

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2. On Amendments to the Tax Code of Ukraine to Improve Tax Administration, Eliminate Technical and Logical Inconsistencies in Tax Legislation: Law of Ukraine of 16.01.2020 No. 466-IX. Date of update: 01.04.2024. URL: <https://zakon.rada.gov.ua/laws/show/466-20#Text> (accessed 10/27/2024).

3. Tax Code of Ukraine: Code of Ukraine dated 02.12.2010, No. 2755-VI. Date of update: 01.04.2024. URL: <https://zakon.rada.gov.ua/laws/show/2755-17#Text> (accessed: 22.10.2024).